

## Message Text

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ACTION EUR-12

INFO OCT-01 EA-07 NEA-10 IO-13 ISO-00 AID-05 CIAE-00

COME-00 EB-07 FRB-03 INR-07 NSAE-00 XMB-02 OPIC-03

SP-02 CIEP-01 LAB-04 SIL-01 OMB-01 NSC-05 SS-15

STR-04 CEA-01 DODE-00 NSCE-00 SSO-00 USIE-00 INRE-00

EURE-00 /104 W

----- 028845

O R 281150Z SEP 76

FM AMEMBASSY LONDON

TO SECSTATE WASHDC IMMEDIATE 5962

TREASURY DEPT WASHDC IMMEDIATE

INFO AMEMBASSY BONN

AMEMBASSY BRUSSELS

AMEMBASSY COPENHAGEN

AMEMBASSY DUBLIN

AMEMBASSY LUXEMBOURG

AMEMBASSY NEW DELHI

AMEMBASSY PARIS

AMEMBASSY ROME

AMEMBASSY THE HAGUE

AMEMBASSY TOKYO

AMCONSUL BELFAST

AMCONSUL EDINBURGH

USMISSION EC BRUSSELS

USMISSION OECD PARIS

USMISSION NATO BRUSSELS

USDEL MTN GENEVA

AMEMBASSY MANILA

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DEPARTMENT PASS FRB

TREASURY FOR DONALD SYVRUD, OASIA

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MANILA FOR USDEL BANK/FUND MEETING

E.O. 11652: N/A

TAGS: EFIN, UK

SUBJECT: PRIME MINISTER'S SPEECH; ECONOMY

SUMMARY: THE PRIME MINISTER STRESSED THAT THE COUNTRY'S ILLS COULD BE TRACED TO A SINGLE CAUSE; THE UK PAYS ITSELF MORE THAN THE VALUE OF WHAT IT PRODUCES. IT MUST GET BACK TO FUNDAMENTALS. LABOR COSTS MUST BE COMPARABLE WITH COMPETITORS. PRODUCTIVITY OF LABOR AND CAPITAL MUST BE INCREASED. THE COUNTRY CANNOT SPEND ITSELF OUT OF ITS DIFFICULTIES. IT MUST EARN ITS WAY OUT. ATTACKING INFLATION IS THE FIRST PRIORITY. THE INDUSTRIAL BASE MUST BE STRENGTHENED. THE PERCENTAGE OF PUBLIC EXPENDITURE TO GDP MUST BE REDUCED. BORROWING HAS GROWN RAPIDLY AND CANNOT CONTINUE AT CURRENT LEVELS. THERE ARE NO SOFT OPTIONS. IN HIS DIAGNOSIS, CALLAGHAN STRESSED THE NEED FOR CONTINUITY OF EXISTING ECONOMIC STRATEGY, FOR COOPERATION BETWEEN GOVERNMENTS, INDUSTRY, AND THE UNIONS, AND THE OVERRIDING IMPORTANCE OF THE SOCIAL CONTRACT. THIS IS NOT NEW. IMPLICIT IN HIS SPEECH--AND VERY CLEAR--WAS THE NEED FOR FURTHER CUTS IN THE LEVEL OF PUBLIC AND PRIVATE CONSUMPTION. THE BASIC PROBLEMS HOWEVER ARE DEEPER AND STRUCTURAL. THE SITUATION CANNOT BE RIGHTED IN A YEAR--IT WILL TAKE LONGER, AND CALLAGHAN REMARKED THAT FOREIGN CREDITORS WHO ARE LENDING TO HELP PROVIDE THE MEANS TO REVITALIZE THE INDUSTRIAL BASE RECOGNIZE THIS. THIS MESSAGE DEALS WITH THE ECONOMIC CONTENT OF THE PRIME MINISTER'S PRESENTATION. OTHER ASPECTS FOLLOW IN SEPTEL.

BEGIN UNCLASSIFIED

1. PRIME MINISTER CALLAGHAN TOLD THE LABOR PARTY CONFERENCE THAT BRITAIN HAD BEEN LIVING FOR TOO LONG ON BORROWED TIME, BORROWED MONEY AND BORROWED IDEAS. IT WAS NO LONGER POSSIBLE TO POSTPONE MAKING THE FUNDAMENTAL CHOICES FACING THE BRITISH ECONOMY.

2. EXPLAINING WHAT HE MEANT BY FUNDAMENTAL ECONOMIC LIMITED OFFICIAL USE

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CHOICES, THE PRIME MINISTER SAID THAT BRITAIN'S BASIC PROBLEM WAS THAT OF "PAYING OURSELVES MORE THAN THE VALUE OF WHAT WE PRODUCE." THIS WAS THE ROOT OF THE INFLATION--UNEMPLOYMENT CYCLE WHICH ENSUED WHEN PREVIOUS GOVERNMENTS TRIED TO SPEND THEIR WAY OUT OF RECESSION.

3. MR. CALLAGHAN STRESSED THAT THE ONLY SOLUTION WAS A RETURN TO FUNDAMENTALS. UNEMPLOYMENT COULD ONLY BE

BROUGHT DOWN BY CONTROLLING THE COST OF LABOR, BY INCREAS-  
ING THE COMPETITIVENESS OF BRITISH INDUSTRY THROUGH TIME-  
LY INVESTMENT AND IMPROVEMENTS IN THE PRODUCTIVITY BOTH  
OF LABOR AND CAPITAL, AND BY RESISTING THE TEMPTATION TO  
PRINT "CONFETTI MONEY" TO COVER ANY DEFICITS. HMG  
WOULD NO LONGER BORROW TO FINANCE A SHORT-LIVED CONSUMER  
BOOM BUT ONLY TO INVEST IN BRITAIN'S FUTURE (I.E., NORTH  
SEA OIL AND INDUSTRIAL REGENERATION).

4. THE GOAL OF THE GOVERNMENT WAS TO REDUCE BRITISH IN-  
FLATION TO A RATE COMPARABLE TO THAT OF HER MAJOR  
TRADING PARTNERS BY THE END OF 1977.

5. IN DESCRIBING WAYS IN WHICH BRITAIN COULD PUT ITS  
ECONOMIC HOUSE IN ORDER, MR. CALLAGHAN EMPHASIZED THE  
ROLE OF THE SOCIAL CONTRACT AND THE NEW INDUSTRIAL  
STRATEGY, WITHOUT WHICH THE TASK WOULD PROVE HOPE-  
LESS. HE SAID THE NECESSARY STEPS WERE KNOWN, THEY HAD

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TREASURY DEPT WASHDC IMMEDIATE

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BEEN OUTLINED IN THE 39 INDUSTRIAL SECTOR WORKING PARTY  
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REPORTS DRAWN UP AS PART OF THE NEW INDUSTRIAL STRATEGY  
EXERCISE. THE CRUCIAL QUESTION WAS CARRYING THEM OUT.

6. HE THEN TOLD HIS AUDIENCE TO HOLD ONTO THEIR SEATS.  
A STRONG MANUFACTURING SECTOR DEPENDED ON A WILLINGNESS  
BY INDUSTRY TO INVEST. THIS, IN TURN, REQUIRED LOWER IN-  
FLATION, BUT MORE IMPORTANTLY, A SURPLUS OF FUNDS IN THE  
HANDS OF INDUSTRY. IN PLAIN LANGUAGE THIS MEANT INDUSTRY  
MUST BE ALLOWED TO MAKE PROFITS. IF THERE WERE NO PROFITS  
THERE WOULD BE NO INVESTMENT AND TRADE UNIONISTS WOULD -  
"WHISTLE IN VAIN" IF THEY DID NOT UNDERSTAND THIS FACT.

7. MR. CALLAGHAN STATED THAT THE CREATION OF WEALTH WAS  
THE KEY TO BRITAIN'S RECOVERY. WHILE THERE SHOULD BE NO  
CONFLICT BETWEEN THE CREATION AND DISTRIBUTION OF WEALTH  
THE SEPTEMBER 27 CONFERENCE VOTE TO ENCOURAGE LOCAL  
AUTHORITIES TO RESIST PUBLIC SPENDING CUTS REFLECTED  
A MISUNDERSTANDING OF THE RELATIONSHIP BETWEEN CREATION  
AND DISTRIBUTION OF WEALTH. HE SAID THAT IT WOULD BE  
FOLLY FOR BRITAIN TO CONTINUE BORROWING AT PRESENT RATES  
EVEN IF LENDERS COULD BE FOUND. THE ONLY LONG-TERM CURE  
WAS A HEALTHY INDUSTRY. THERE WAS NO ROOM FOR GIMMICKS.

8. ON SELECTIVE IMPORT CONTROLS, THE PRIME MINISTER SAID  
THAT HMG WOULD CONTINUE TO MAKE JUDGMENTS ON A CASE-  
BY-CASE BASIS, ACTING ONLY WHEN IT COULD BE DEMONSTRATED  
THAT THE BALANCE OF ADVANTAGE LAY WITH BRITAIN. HE SAID  
HE WOULD BE DISCUSSING THE ISSUE OF JAPANESE TRADE AT THE

NOVEMBER EC HEADS OF STATE MEETING IN THE HAGUE.

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9. COMMENT: CALLAGHAN'S MAIDEN PRIME MINISTERIAL SPEECH TO HIS PARTY CONFERENCE WAS STATESMANLIKE, HONEST. IN SOME WAYS BRAVE. HE DID NOT MINCE WORDS' AND MUCH OF WHAT HE SAID MUST HAVE BEEN UNPALATABLE TO MANY OF THE DELEGATES. HIS DIAGNOSIS COULD HAVE BEEN WRITTEN BY THE IMF. CALLAGHAN CERTAINLY HAD STERLING'S RAPID FALL VERY MUCH IN MIND AS HE FORCEFULLY LAID THE FACTS OF ECONOMIC LIFE ON THE LINE. CALLAGHAN'S SPEECH WAS AN EXCELLENT PRESENTATION OF THE COUNTRY'S ILLS AS WELL AS A PRESCRIPTION OF WHAT MUST BE DONE TO RESTORE THE NATION'S LIMITED OFFICIAL USE

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ECONOMIC HEALTH. IT REMAINS TO BE SEEN IF THE PATIENT WILL TAKE THE MEDECINE.

ARMSTRONG

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## Message Attributes

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**Disposition Approved on Date:**  
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**Disposition Case Number:** n/a  
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